

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Statutory Review of the System )  
for Regulating Rates and Classes )  
for Market Dominant Products )

Docket No. RM2017-3

**THE VALPAK FRANCHISE ASSOCIATION, INC.**  
**REPLY COMMENTS ON THE NOTICE OF PROPOSED RULEMAKING**  
**FOR THE SYSTEM FOR REGULATING RATES AND CLASSES**  
**FOR MARKET DOMINANT PRODUCTS**  
(March 30, 2018)

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The Valpak Franchise Association, Inc. (hereinafter “Valpak”) hereby submits these Reply Comments in response to Initial Comments that were filed on Commission Order No. 4258, “Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products.”

**I. The CPI-Based Price Cap Should Be Retained.**

**A. Pre-implementation Review of Pricing Should Be Continued.**

The Postal Service begins its criticism of the Commission’s proposal not for what it does, but rather because it does not simply adopt the Postal Service’s proposal in its entirety. The Postal Service criticizes the Commission’s proposal for failing to explain adequately or justify its reasons for rejecting the Postal Service’s proposal to obliterate the price cap. *See* USPS Initial Comments, Section III. The Postal Service summarizes its position as follows: “the Commission cannot simply dismiss the Postal Service’s proposal without offering a **reasoned explanation** for its choice not to use its broad authority to adopt a proven alternative model” that was offered by the Postal Service. USPS Initial Comments at 48 (emphasis added). This position may be rejected by the Commission.

The Postal Service claims that “the Commission must provide a reasoned explanation of its choice to retain a price cap, especially in response to ‘vital comments’” — thereby referring to its own comments as “vital.” USPS Initial Comments at 36 and n.88. To be sure, all notice-and-comment rulemaking requires “reasoned decisionmaking” (Allentown Mack Sales & Serv. v. NLRB, 522 U.S. 359, 374 (1998)), but the authority invoked by the Postal Service for “ignor[ing] vital comments” does not stand for the proposition the Postal Service claims. In fact, the quotation employed in the Postal Service’s footnote 88 is actually not from the case cited, but from a different case — Western Coal Traffic League v. United States, 677 F.2d 915, 927 (D.C. Cir. 1982). And the case erroneously cited in footnote 88 actually stands for the opposite of the Postal Service’s point: “[The APA] has never been interpreted to require the agency to respond to every comment.... The failure to respond to comments is significant only insofar as it demonstrates that the agency’s decision was not ‘based on a consideration of the relevant factors....’” Thompson v. Clark, 741 F.2d 401, 408-09 (D.C. Cir. 1984) (quoting Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 416 (1971)). The Commission’s proposal clearly demonstrates that the Commission considered the Postal Service’s comments, but did not adopt them, instead concluding that maintaining a form of price cap better serves the objectives specified in the Postal Accountability and Enhancement Act of 2006 (“PAEA”), which contained a price cap as its centerpiece. The Commission is not obligated to explain in detail why it rejected each element of the Postal Service’s proposal.

In determining to maintain the price-cap type system for regulating market dominant prices (Order No. 4257 at 34), the Commission correctly concluded that the price-cap system has provided significant stability and predictability in rates since PAEA was enacted, and “has

engendered serious reliance interests that must be taken into account.”<sup>1</sup> Mailers have come to rely on CPI-based price increases as a metric against which to create business plans and marketing strategies and campaigns, and it was appropriate for the Commission to point to the predictability and stability that the price cap creates, as well as the mailing industry’s reliance on that predictability and stability.

The Postal Service describes the power of the Commission to adopt an alternative pricing system (*id.* at 32), the breadth of options that the Commission could adopt for alternative systems (*id.* at 33-35), and how the Postal Service believes that its proposal would be much better than the Commission’s (*id.* at 40-45). The Postal Service acknowledges that the Commission could use a wide range of modes of regulation: “revenue targets, cost-of-service regulation, and any other type of system that the Commission might find.” *Id.* at 34. The Postal Service itself references legislative history that almost any form of ratemaking system would comply with the language of Objective 2 — including price caps. *See* USPS Initial Comments at 38, n.93.

However, the Postal Service asserts that the Commission’s proposal to maintain the central feature of PAEA runs contrary to Objective 2, which is, of course, also part of PAEA. *Id.* at 36-40. The Postal Service criticizes the Commission’s reference to Objective 2 as a reason for keeping a price-cap system of regulating rates. The Postal Service asserts that the Commission based its decision on the flawed view that Objective 2 **requires** use of a price cap, but the Commission only said that Objective 2 requires predictability and stability, and a price-

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<sup>1</sup> FCC v. Fox TV Stations, Inc., 556 U.S. 502, 515 (2009).

cap system fulfills that requirement. The rest of the Postal Service's analysis of Objective 2 is based on this same erroneous reading of the Commission's Order.

Furthermore, the Postal Service indicates that the Commission should have done more to explain its basis for maintaining the price cap. However, it is not maintaining the status quo that requires more explication, but rather a change of agency policy position that requires more, especially where there are serious reliance interests. The Postal Service conveniently ignored the lines of cases that have held to this principle, including the Supreme Court's recent decision in Encino Motorcars v. Navarro, 136 S.Ct. 2117, 2125-26 (2016). The Commission has a decade of experience with the price cap and made findings with respect to retaining the price cap in both Order No. 4257 (at 103) and Order No. 4258 (at 33). With respect to its decision to maintain some form of a price-cap regimen, there was more than adequate reasoned decisionmaking.<sup>2</sup>

The Postal Service's primary goal is for greater and greater "pricing flexibility," as has been its consistent refrain for several years. The Postal Service sees any obstacle to its unfettered pricing discretion — including Commission pre-implementation review of price changes — as an unacceptable limitation on its plenary pricing authority. Such an extreme position is inconsistent with the objectives and factors of the Act.

The Postal Service repeats arguments drawn from its comments in the first stage of this 10-Year Review that it has offered the best proposal for an alternative system, claiming that its proposal would achieve "every statutory objective." USPS Initial Comments at 44. But the

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<sup>2</sup> Valpak supports maintaining a price cap; it is the Commission's proposed modifications to the price cap with which Valpak disagrees. See Sections II-IV, *infra*.

Postal Service's proposal is really just a proposal for unbridled and virtually unregulated Postal Service pricing authority, which really would not be a rate setting system at all. The Postal Service's proposal would provide for no pre-implementation regulation of market dominant product pricing, and only a superficial, ex post "regulatory-monitoring approach." *Id.* Its proposal would have the Commission casually monitor Postal Service pricing "to ensure that market forces are adequately keeping it within the bounds of 'stability.'" *Id.* at 42. Such monitoring would be redundant to the annual compliance review required by 39 U.S.C. § 3653. The 10-Year Review authorizes the Commission to modify the price-cap system or adopt an alternative system, but it does not authorize the Commission to delegate pricing entirely to the Postal Service and thereby eliminate any meaningful "system for regulating rates and class for market-dominant products." 39 U.S.C. § 3622(a) and (d)(3).

Actually, the Commission's current *ex ante* reviews of market dominant pricing under PAEA have provided very few constraints on Postal Service pricing, allowing not too little, but too much pricing flexibility. The Postal Service claims that "the threat of [Commission] intervention itself would serve as a regulatory check against theoretical abuses by the Postal Service." USPS Initial Comments at 45. However, experience of the past decade has disproved every element of that sentence. Abuses have not been theoretical, as Commission Annual Compliance Determinations ("ACDs") have found Postal Service noncompliance with PAEA with respect to marketing mail flats to be actual and substantial. The threat of remedial orders in the ACDs has not deterred the Postal Service from continued noncompliance. Indeed, in recent years, the Postal Service has maintained a perpetual state of noncompliance despite remedial orders. If anything, the Commission findings over the past decade, as set out



in Order No. 4257, demonstrate that *ex ante* pricing regulation is more important than ever, to protect mailers so long as the Postal Service is a government monopoly.

**B. Various Proposals to Apply Complex Adjustment Factors to the Price Cap Should Be Rejected.**

The Postal Service and the Public Representative (“PR”) both argued that the price cap should include adjustment factors to take into consideration the Postal Service’s changes in economies of density, described as declining mail volume with an increasing number of delivery points. The Postal Service urged the Commission to adjust the price cap based on “exogenous” factors, such as congressionally imposed costs. Similarly, the PR argued that the price cap should be adjusted for exogenous factors to address uncontrollable costs. The Postal Service added that a “hybrid cap formula would adjust the price cap to allow the Postal Service to recover through pricing the contribution to institutional costs that is lost due to declines in mail volume and changes to the mail-mix, as well as to offset increased institutional costs caused by growth in the delivery network.” USPS Initial Comments at 72. The PR relied on a declaration by Dr. Timothy J. Brennan to propose adjusting the price cap in a declining demand market. *See* PR Initial Comments at 55-56. Based on Dr. Brennan’s formula, for example, the price cap for Marketing Mail would be increased by exactly 0.93 percent. *See* Supplemental Declaration of Timothy J. Brennan for the PR at 8.

Adding additional pricing authority based on all of these factors on top of CPI would largely negate the CPI-based price cap, and it certainly would make it much more complex and cumbersome. The Postal Service already complained of the unnecessary complexity caused by adjustments to the price cap. *See* USPS Initial Comments at 48. The current price cap

provides a simple, objectively measurable method to limit price increases. Adjusting the price cap to account for these many and varied factors would reduce the transparency of the ratemaking process (Objective 6) by making it increasingly complex as well as lessen the predictability and stability of rates (Objective 2). Moreover, allowing complex price cap adjustments to allow recovery of additional Postal Service costs actually constitutes a masked proposal to return to achieve cost-of-service ratemaking without the protection of Commission-set rates.

## **II. The 2 Percentage Point Supplemental Pricing Authority Should Not Be Implemented.**

### **A. A 2 Percent Supplement Will Not Solve the Postal Service's Problems, which Were Created by Statute and Require a Statutory Fix.**

The PR's Initial Comments explain that the Commission's proposed annual 2 percentage point supplemental pricing for five years is based on the Commission's estimate of the FY 2017 loss of \$2.7 billion. *See* PR Initial Comments at 6. Indeed, the Commission does state, "[i]n determining the amount of supplemental rate authority, the Commission uses the \$2.7 billion FY 2017 net loss as its reference point." Order No. 4258 at 38.

The Commission's "reference point" — FY 2017 net losses — is an improper basis for granting the Postal Service temporary (5-year), above-CPI pricing authority. As Valpak explained earlier, this remedy is disconnected from the annual net losses that the Postal Service has shown in its financial reports. *See* Valpak Initial Comments at 12. Likewise, the Initial Comments of the American Mail Alliance address the fact that the Postal Service's net losses are the result of "a Congressional problem that needs a Congressional solution." AMA

Comments at 6. NPPC, *et al.*, also note that the Commission’s conclusions on financial stability “ignore[] a decade of successful operation....” NPPC, *et al.*, Initial Comments at 6.

The Commission has given the Postal Service’s net losses incurred too much prominence, and in turn have not sufficiently recognized the Postal Service’s operational profits. As Commissioner Hammond noted, “a significant portion of the Postal Service’s financial instability results from an overly aggressive retiree health benefits prefunding schedule — which warrants a legislative solution.” Hammond Dissent at 1. Likewise, Vice Chairman Acton correctly observed that “[m]any of the Postal Service’s greatest challenges are not a primary result of the rates that it charges....” Acton Supplemental Views at 1.

**B. Supplemental Pricing Authority Was Not Supported by Reasoned Analysis and Would Not Pass APA Scrutiny.**

The PR believes that “the apparent reset of rates to recover revenue equivalent to the level of the FY 2017 losses is ... without underlying principle.” PR Initial Comments at 7. The PR concludes that “[o]f primary concern ... is the fundamental lack of any analytical framework that utilizes economic principles to support the Commission’s determination to modify the price cap with a 2 percent annual supplemental rate authority” because the Commission’s proposed rules “do not rest upon appropriate principles and rely upon an insufficient conceptual framework.” *Id.* at 15. Valpak agrees with the concerns that the PR raised about the adequacy of the Commission’s reasons for proposing supplemental pricing authority.

The Commission’s purported justification ignored the Postal Service’s operational profit. As the American Mailers Alliance correctly notes, “the Postal Service is still covering

its operating expenses.” AMA Comments at 6. At several points, the Initial Comments of ANM, *et al.*, reports that “the Postal Service boasts cash reserves that exceed \$10 billion, and generates about \$3 billion in additional cash from operations each year.” ANM, *et al.*, Initial Comments at 4. Thus, the losses are not operational, and yet the Commission’s proposal would impose the supplemental pricing on mailers all the same to increase Postal Service revenues, with no condition being placed on the use of these additional funds. Would they be used to make up the net losses, *i.e.*, to pay for the RHBF and CSRS payments? Or rather would such additional funds be expended solely on capital expenditures, in which case the Postal Service will continue to experience net non-operating losses such as unpaid RHBF and CSRS liabilities? Thus, the Commission has failed to tie the reason for the increase — the Postal Service’s net losses — to how the additional revenue it would provide would be used by the Postal Service. The Administrative Procedures Act requires more.

The Public Representative makes a similar argument with respect to the performance-based additional pricing authority:

It appears the NOPR intends to remedy the lack of long-term financial stability. That remedy is clearly inadequate. The addition of 1 percent performance-based rate authority will, if collected, be necessarily required, instead, to meet the obligations for exogenous costs and, therefore, as a practical matter, will not be available for additional capital outlays or to increase net asset holdings. Accordingly, the Commission’s decision to [alot] 1 percent in performance-based rate authority is arbitrary and capricious. [PR Initial Comments at 32.]

There is no Commission requirement that all funds raised from either of its two types of additional pricing authority be used in any particular manner. The performance-based incentive simply provides additional funds — and, for example, 0.75 percent additional pricing authority on a base of, for example, \$48 billion in revenues is \$360 million. Once that money

is earned, it will go into the Postal Service's accounts, and not be traceable to any particular expense — even the congressionally imposed exogenous costs, which are not being paid in any event.

**C. Volume Impact of Supplemental Pricing Authority Has Not Been Appropriately Considered.**

Valassis and Discover Financial Solutions both address the effect of the Commission's supplemental pricing proposal on mail volumes. Valassis Initial Comments at 5-6 and Discover Initial Comments at 5-6, 10-11. Valpak is also concerned that, although the Commission recognized that there would be an effect of the supplemental pricing on mail volume, it failed to integrate that finding into its analysis. Order No. 4258 at 42.

Demand is certainly not generally inelastic. *See* PR Initial Comments, Table 2. The effect of any Commission proposal on volume and revenues must be considered. Indeed, the “effect of rate increases upon the general public [and] business mail users” is one of the factors that the new pricing system is to take into account. 39 U.S.C. § 3622(c)(3). Without such a consideration affecting its decision, the Commission has not fully discharged its statutory responsibility. When volume effects are considered, it becomes clear that supplemental pricing authority will come at a heavy cost in lost volume and revenue, the highly profitable especially for products with highly elastic demand.

**D. If Approved, Supplemental Pricing Authority Should Not Be Part of the Base Rates, but Only a Surcharge that Expires.**

The Commission proposal for above-CPI supplemental pricing authority essentially gives the Postal Service an exigent price increase for five years, without regard to the standards and protections provided by the current exigent price increase mechanism. The

Initial Comments of NPPC, *et al.*, note that the exigency provision of § 3622 has a standard of “honest, efficient, and economical management.” NPPC, *et al.*, Initial Comments at 49.<sup>3</sup> NPPC, *et al.*, also note that the Commission rejected this standard because it fails to generate retained earnings (Objective 5). *Id.* (citing Order No. 4257 at 154).

NPPC, *et al.*, explain that the supplemental pricing increases “would compound” and “would remain in the base rates after the fifth year.” *Id.* at 45-46. *See also* Valpak Initial Comments at 11-14. This is an important point. If the Commission is going to integrate what amounts to an exigent price increase, it should follow the approach it followed for the Docket No. R2013-11 exigent price increase and make it a temporary surcharge that expires at the end of a specified period, after which the Postal Service returns to its current pricing level, plus CPI and no more.

### **III. The Postal Service’s Position on Performance-Based CPI Pricing Authority Is Flawed.**

Valpak opposes the Commission’s plan to grant 2 percentage points above CPI as supplemental rate authority. *See* Valpak Initial Comments at 11-14. And Valpak opposes the Commission’s proposal to grant 1 percentage point above over CPI and supplemental rate authority conditioned on performance. *See id.* at 8-11. However, Valpak believes that should the Commission be inclined to give any additional pricing authority, that authority should be conditioned on Postal Service increased productivity. There should be no “give-aways” of mailer money to the Postal Service without requiring that the Postal Service operate in a more

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<sup>3</sup> Note the requirement of “best practices of honest, efficient, and economical management” is not only found in the exigent pricing provisions, but is contained in 39 U.S.C. § 404(b), which must be considered as a factor in the ratemaking system through Factor 14.

business-like and efficient manner, demonstrating increasing, not decreasing, efficiencies. The Postal Service's criticism of this proposal for performance-based pricing authority is not well founded.

The Postal Service devoted a remarkable 50 pages of its Initial Comments to criticize the Commission's proposal to allow it an additional 1 percentage point of pricing authority conditioned on performance, plus devoting additional space to its criticism of its own Total Factor Productivity ("TFP") measure. *See* USPS Initial Comments at 22-25, 80-131. The Postal Service presents an analysis based on pessimism, that it simply cannot achieve any further efficiencies without massive infusions of funds for capital investments. *See id.* at 81 ("[T]he Postal Service needs more capital to invest before it can significantly improve performance.... [T]he performance incentive mechanism's ... proposed efficiency component ... would almost certainly render it unachievable ... for most or all of the initial five-year period."). And the Postal Service argues that it simply cannot achieve any further efficiencies with the "constraints of its statutory structure" under which it operates. *See id.* at 23. For these reasons, apparently, the Postal Service seems to argue that the incentive of additional price-cap authority being offered by the Commission would be meaningless, and not affect its behavior. Not so.

Increasing productivity is the hallmark of a successful business. On the other hand, no business can survive long with year-after-year productivity declines — except one type of business: a government-sanctioned and protected monopoly. It is the Commission's obligation to regulate the Postal Service, and in this case, the effort to provide performance-based pricing relief is the only way on which any additional pricing authority should be provided.

The Postal Service first proposes its “simplest solution” to the Commission’s proposal to require it to operate efficiently — which would be for the Commission to just make the additional performance-based rate authority “unconditional.” *Id.* at 81. While, doubtless, that solution would, as the Postal Service explains, “ensure a predictable, stable stream of capital” to the Postal Service, at the same time it would undermine the Commission’s obligation to ensure the new system provides sufficient incentives for the Postal Service to operate on an efficient basis, consistent with Objective 1.

If the Postal Service had more money, without the requirement of increasing productivity, it could recover what it spent it on projects like the Flat Sequencing System (“FSS”) — an utter disaster for which, apparently, not one person at the Postal Service has been held accountable. *See* Initial Comments of ANM, *et al.* at 8, 92-94. Or, if the Postal Service was just given more money, on an “unconditional” basis, it could feel at liberty to give even bigger price breaks to its favorite underwater products.<sup>4</sup> Without some performance condition being imposed, the money extracted from mailers could be spent on anything other than that which would increase productivity.

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<sup>4</sup> Pricing decisions should be used to encourage mailers to enter mail in a form which the Postal Service can handle efficiently (*e.g.*, letters), and discourage mailers to enter mail in a form which the Postal Service has demonstrated that it cannot handle efficiently (*e.g.*, flats). *See* Objective 1 and Factor 7. If the Postal Service underprices Marketing Mail Flats, it will get more of those pieces entered, and, as a result, will lose more money. If at the same time, to make up for those losses, it overprices products like HD/Saturation Letters, which are highly profitable (with a current coverage of 212 percent), mailers will enter fewer of those pieces, and the Postal Service will make less money. In this way, the Postal Service, through the use of its unconstrained “pricing flexibility,” has deliberately chosen to handle more of the type of mail it handles inefficiently — a decision which no business in America could long afford to make.



It is simply wrong to require mailers to pay more for less — paying above-CPI price increases at the same time that the Postal Service receives, processes, transports, and delivers the mail in an increasingly inefficient manner. The record demonstrates that Postal Service efficiency has been declining in recent years, no matter how it is measured. *See* Valpak Initial Comments at 9-10. Inefficiency must not be rewarded by further extractions of capital from mailers to provide infusions of capital to the Postal Service.

The Postal Service seeks to dismiss the significance of declining TFP, even while admitting that “[t]he comprehensive nature of TFP makes it a helpful metric....” Actually, it is more than that. Indeed, the report from Christensen Associates entitled “Total Factor Productivity as a Measure of Operational Efficiency,” submitted to the Commission as Appendix D to the Postal Service’s March 20, 2017 comments, explains TFP in a somewhat different light:

TFP is a comprehensive measure of operational efficiency. TFP is a measure that compares the level of workload (**weighted mail volume**, miscellaneous output, and **delivery points**) to the level of resource usage, as compared to real unit operating costs, workhours, and simpler productivity measures such as the number of pieces per workhour or the number of delivery points per workhour. [Christensen Associates Report at 1 (emphasis added).]

The Postal Service appears to argue that TFP does not account for what it called “the ongoing headwinds of delivery-point growth and the shift in the mail mix toward higher-cost products.” That criticism is inconsistent with how the Christensen Associates Report describes TFP — evaluating “**weighted mail volume**.” Indeed, it has always been understood that TFP did account differently for a postcard versus a 70-pound parcel. That is one of the reasons that it was chosen to replace the Gross Factor Productivity (“GFP”) used prior to the early 1980’s

when the Board of Governors of the Postal Service insisted that GFP be abandoned.<sup>5</sup> Thus, the “shift in the mail mix” is fully accounted for by TFP.

Additionally, the Postal Service raises the problem of the headwind of “**delivery-point** growth,” but as the quotation from the Christensen Associates Report indicates, that factor too is included in the TFP analysis. Neither of the Postal Service’s explanations for declining productivity are at all consistent with TFP, as explained by its long-term contractor, Christensen Associates.

The Commission’s finding in Order No. 4257 that TFP is the best available measure of efficiency is undoubtedly correct. *Id.* at 225. And, the Commission’s finding that under PAEA the Postal Service has not operated efficiently is also undoubtedly correct:

[E]fficiency increases were not maximized during the [PAEA era]. In the maximization analysis, the Commission determines that: (1) gains were not achieved in cost reductions and operational efficiency sufficient to contribute to the financial stability of the Postal Service; and (2) cost reductions and operational efficiency increases were not achieved at a greater rate when compared to the relevant time period of the 10 years immediately prior to the implementation of the PAEA. [*Id.* at 248.]

Therefore, it is entirely logical for the Commission to establish new incentives for the Postal Service to increase productivity.

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<sup>5</sup> Prior to the early 1980’s, the Postal Service measure of Gross Factor Productivity always showed increasing productivity. However, that improvement was illusory. Moreover, during collective bargaining, unions would point to the astonishing, yet fallacious, supposed increases in productivity as the basis for salary increases. Once TFP was instituted at the direction of the Board of Governors, and Christensen Associates was engaged, the Postal Service finally had a real, meaningful measure of productivity. Unfortunately, the Postal Service now seems determined to undermine the value of the TFP measure to buttress its argument that the Commission should be unconcerned about declining productivity as accurately measured by TFP.

One of the problems associated with a government monopoly — at least for the Postal Service, with respect to market dominant products — is that it does not face the discipline of the market. Curiously, under the Postal Reorganization Act of 1970's ("PRA") "cost-of-service" approach, it appears that the Postal Service was more rigorously focused on achieving productivity gains than at present. This may seem counter-intuitive, as "cost-of-service" allowed the Postal Service rates which provided for the recovery of virtually all expenses incurred, and the current "price cap" system supposedly does not.<sup>6</sup> One of the reasons that the much-maligned "cost-of-service" system may have spurred greater efficiencies at the Postal Service was that the Commission previously functioned as a true regulator, and set prices of all products. Today, the Commission has yielded virtually all pricing authority to the Postal Service.

With the Commission holding pricing power under the PRA, the Postal Service was not able to make choices that made no economic sense, such as the years of losses incurred on Marketing Mail Flats, which have now totaled over \$5 billion just during PAEA. In addition to setting prices in a manner that guaranteed losing around a half-billion dollars per year on just that one product, other cost-saving approaches have been eschewed. During this period, the Postal Service has flatly refused to explore moving from door delivery to more efficient

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<sup>6</sup> The "price-cap" system in place since 2008 has already seen one exigent rate increase provide above-CPI pricing authority, and now the Postal Service seeks money to repay it for what it actually spent over the last decade, even though the "price-cap" system did not allow that money to be recovered. Thus, the current system is already viewed by the Postal Service as a "price-cap PLUS" system.

and less costly cluster box and other approaches. *See* Docket No. ACR2011, Valpak Initial Comments (Feb. 3, 2012) at 93.

Those who crafted PAEA believed that giving significant “pricing flexibility” to the Postal Service, an agency with attributes of both a *de facto* and a *de jure* government monopoly, would work well, but the evidence is now in. It has not worked well. It no doubt would have worked better had the Commission assumed the role of a true “Postal Regulatory Commission,” but it has reduced its role well below that exercised when it was the “Postal Rate Commission.” Light-handed regulation has been the order of the day. Even when the Commission believed the Postal Service’s pricing decisions violated PAEA, there has been almost unlimited deference granted. Review of pricing decisions has come long after the damage inflicted by those rates has occurred. Too often the Commission has viewed itself as the partner of the Postal Service, rather than its regulator. No meaningful effort has been made to remedy pricing abuses, even when the law was found to be violated. *See* FY 2010 ACD at 106. The complaint process has been ineffectual.

For all these reasons, no additional pricing authority should be granted “unconditionally,” but, rather, if the Commission grants any, it must be “conditional” only on increased service performance. Valpak would repeat its recommendation that there should be no additional pricing authority given, but if there is to be any increased pricing authority above CPI, that it must be made conditional upon the Postal Service achieving increases in productivity.

#### **IV. The Proposal for a Service Mechanism Component Was Properly Criticized.**

The Comments filed by Netflix make an important point about the “Service Mechanism Component of the “Performance Incentive Mechanism.” “First, this mechanism deals only with service standards, not actual performance.... The Postal Service can realize the 0.25% reward simply by doing nothing — it need not take any action to improve actual performance.... [r]ewarding the Postal Service for not changing service standards may be counter-productive to effective operations.” Netflix Initial Comments at 22-23. Valpak agrees with these reasons, and opposes the “Service Mechanism Component” of the “Performance Incentive Mechanism.”

The UPS recommendation that “half” of any “market dominant rate authority above the CPI ... should be contingent on ... maintaining high quality service standards.” UPS Initial Comments at 5. For the reasons set out by Netflix, Valpak opposes this proposal, as well as the Commission’s proposal for any additional pricing authority based on stated service standards.

#### **V. Workshare Discounts.**

##### **A. Postal Service.**

The Postal Service made a number of important comments concerning the Commission’s proposal with respect to Workshare Discounts. USPS Initial Comments at 146-48. Valpak believes that to achieve efficient component pricing, there is significant merit to ensuring that prices are set so that costs avoided are reflected in the prices of workshared mail. However, over the period that PAEA has been in force, it has been observed that there have

been many reasons that passthroughs may change significantly over time in unpredictable ways. Thus, the Postal Service observed:

passthrough ratios can shift significantly from price change to price change and from one annual compliance review to the next, due to non-pricing factors like changes in costing methodology or changes in mail mix and operational efficiencies. Creating even more reasons to continually adjust prices on the basis of such exogenous changes would erode the predictability and stability of workshare prices, thereby implicating objective 2. [*Id.* at 147.]

The Postal Service analysis is correct. Accordingly, the Postal Service offers three suggested changes to these proposed rules. Valpak supports each of these changes.

Valpak supports the first of these changes — retaining the “exceptions and limitations in Section 3622(e)(2)-(3)” (*id.* at 147) would allow for a degree of judgment to be exercised to ensure that large price swings do not occur each year for the same mail, being handled the same way, just because of changes in, for example, costing methodology or errors in costing.

Valpak also supports the second of these suggestions relating to “expansion of the bands” (*id.* at 147) to allow adjustments to the nearest tenth of a cent. Indeed, Valpak would go further, as it did in its Initial Comments (Valpak Initial Comments at 18), and propose that the wider band proposed by the Commission for Periodicals (75 percent to 125 percent) should apply also to Marketing Mail, rather than the band proposed (85 percent to 115 percent). This wider band should also help avoid unnecessary price swings due to “exogenous changes.”

And Valpak supports the third of these suggestions, to begin the three-year grace period so that it “starts with the implementation date of the first general price change after the effective date of the new rules,” rather than beginning as soon as the rules become final. *Id.* 147-48.

**B. Pitney Bowes.**

One commenter, Pitney Bowes, proposes that the Commission-recommended bands, at least for mail other than Periodicals, be narrowed, rather than widened, on the theory that the closer the passthrough is to exactly 100 percent, the better — as a matter of theory. Pitney Bowes Initial Comments at 10. Of course, that same efficient component pricing theory presumes that the exact costs avoided by the worksharing being performed are known with certainty. That is an unrealistic assumption anywhere in the world, and particularly in the world of postal costing. Workshare costs for various products in multiple classes have moved significantly from year to year with no discernable change in processing or transportation. Occasionally, mistakes in methodology are identified, but even after a mistake is corrected, it is another mistake to believe that there are not more mistakes lurking. And it has been thought by many for many years that measured costs avoided often understate costs actually avoided by worksharing.

The Pitney Bowes suggestion of a band of setting prices so that workshare discounts must be between 95 and 105 percent would be so tight that it unnecessarily and unwisely could compel pricing fluctuations based on cost analyses which could be incorrect by 10-20 percent or more. By way of illustration of the danger of an unrealistically low upper bound, a measured cost avoidance of 2.0 cents could really be 2.4 cents if the capital “T” Truth were known, and increasing the price of workshared mail by a few tenths of a cent just to reduce the measured cost avoidance in order to stay within the Pitney Bowes 105 percent cap actually could cause the price of the workshared product to be increased when it could have been decreased. Excessive prices would have a deleterious effect on the volume of that workshared

mail, especially for products with very high elasticity of demand which highly workshared products generally have.

It is a grave mistake to believe that any cost avoidance methodology leads us to the capital “T” Truth. The costs we have are good, and probably the best that we can have at this point in time, but no one believes they are perfect. At the Postal Service, funds for cost avoidance special studies no doubt are hard to come by, and outdated assumptions sometimes continue even when re-examination of costing is warranted. For this reason alone, in addition to the reasons set out by the Postal Service, *supra*, a band of 75-125 percent makes much more sense than even the Commission band of 85 to 115 percent, and for this reason the Pitney Bowes band of 95 to 105 percent makes no sense at all. *See* Valpak Initial Comments at 19 for further discussion of how a costs-avoided analysis does not measure the true cost of workshared products.

### C. NPPC, MMA, and NAPM.

The Comments filed jointly by NPPC, MMA, and NAPM make a proposal identical to that of Pitney Bowes — that the permissible range be limited to a very tight 95 to 105 percent. NPPC, *et al.*, Initial Comments at 42. The arguments made in support of this narrow range reveal what appears to be the true concern of these “First-Class Business Mailers” — artificially low passthroughs of workshare costs avoided for First-Class Mail:

- “The Postal Service’s history over the course of the PAEA era of **reducing** workshare pass-throughs demonstrates the need for a more narrow range than proposed.” *Id.* (emphasis added).
- “[T]he Postal Service has set the vitally important discount at the 5-Digit Automation tier (which accounts for the majority of First-Class Letter Presort Letter Mail) at **less than** 90 percent.” *Id.* at 44-43 (emphasis added).



- “[T]he Postal Service **shrank** the Automation Letter pass-through from 100 percent in Docket No. R2017-1 to 83 percent.” *Id.* at 43 (emphasis added).
- “The story of the pass-through from the Metered Mail benchmark to the Nonautomation Presort Letter rate is even more dismal — a **meager** pass-through of 16.3 percent....” *Id.* at 43 (emphasis added).
- “These uneconomic pricing signals have discouraged the mailing industry from performing work that it could do more efficiently than the Postal Service.” *Id.*
- “Order No. 4257 correctly observed (at 216) that ‘workshare discounts set substantially **below** avoided costs may cause the Postal Service to maintain a larger network or retain more processing operations than necessary.’” *Id.* (emphasis added).

None of the provided examples, comments, or even the quotation from Order No. 4257 demonstrate that abusive Postal Service pricing involves passthroughs over 100 percent, and none of the examples involve Marketing Mail. There is an obvious reason that the main problem that can occur from pricing flexibility involves setting passthroughs at too low a level — because understating passthroughs discourages mailers from engaging in worksharing. Excessive prices for workshared mail causes mailers to enter mail which must be sorted and transported in a way that is more expensive than the cost for the mailers to have that work done or do it themselves. The Postal Service has a continuing temptation to understate passthroughs to capture the business of sorting and transporting this mail. Therefore, there are good reasons the Commission rules should provide a floor on passthroughs. The same considerations do not apply to passthroughs of over 100 percent, as the Postal Service should be thought to have a very good reason to allow those, as they are against its interest to help sorting and transportation work in the system. For this reason, it is just as important that the Postal Service set a minimum percentage passthrough than it set a maximum percentage

passthrough. There need not be complete parallelism of passthroughs under or over 100 percent. In other words, even if there is merit to the Commission adopting a minimum passthrough of 85 percent to guard against Postal Service forcing mail into its system, it could still allow a maximum percentage pass through of 125 percent — as proposed by Valpak for the higher bound in its Initial Comments. *See* Valpak Initial Comments at 18.

**VI. Arguments Against Curtailing the Financial Damage Being Done to the Postal Service and Other Products by Deeply Underwater Marketing Mail Flats Are Unavailing.**

**A. The Postal Service.**

Predictably, the Postal Service opposes the Commission’s proposal to require that the Postal Service lose less money each year on Marketing Mail Flats. USPS Initial Comments at 142-146. The Commission’s proposal to require the Postal Service to increase prices for this product by 2 percentage points above the class average, while protecting the other products in the class from carrying the extra burden of subsidizing underwater Flats, seems like a modest proposal and difficult to criticize. Indeed, as Valpak explained in its Initial Comments, it is now clear that the amount of the annual increase needs to be well more than 2 percentage points, because the Commission’s proposal was based on FY 2016 data, before the Postal Service filed its FY 2017 ACR which revealed that losses on Flats had grown significantly larger. *See* Valpak Initial Comments at 5-7.

However, the Postal Service finds a basis on which to criticize it — as a violation of “pricing flexibility.”<sup>7</sup> USPS Initial Comments at 142. Of course, virtually any constraint on

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<sup>7</sup> The Commission recognized that its proposal would limit Postal Service “pricing flexibility” because it was necessary to do so. *See* Order No. 4258 at 77.

Postal Service pricing based on one or more objectives and factors of PAEA is susceptible to being called a violation of “pricing flexibility.” Here, the Postal Service admits that the Commission proposal for underwater products serves Objective 1 (“allocative efficiency”). And, as the Commission has noted on numerous occasions, the factors and objectives are regularly found to be in some tension. Order No. 536 (Sept. 14, 2010) at 36 (“Tension is inherent between most of these qualitative standards.”). Pricing flexibility is simply one of the objectives, not the prime directive, and all the objectives must be balanced against each other. Naturally, no one objective — including pricing flexibility — can ever or should ever be fully achieved because of this natural tension.

When Postal Service pricing, year-after-year, has allowed one favored product to lose over a half billion dollars per year, harming both the Postal Service and overcharging the other products within Marketing Mail, PAEA requires the Commission to impose a constraint on Postal Service “pricing flexibility.”

The Postal Service does not ever appear to deny that the Commission has the full authority to require money-losing products pay a little more each year, so that the Postal Service loses less money. Indeed, to take that position would be without any legal foundation. Therefore, the Postal Service simply argues: not now, maybe later. The Postal Service urges the Commission to “hold the forcible reallocation of pricing authority in reserve. Such a remedy should not be applied as a first resort, but as a last resort [i] for **truly persistent negative-cost-coverage situations**, after [ii] the Commission concludes that **other efforts to improve cost coverage have failed.**” USPS Initial Brief at 142 (emphasis added).

As to the first reason for delay, one could scarcely imagine a product being offered by any business, or even the Postal Service, that year-after-year loses as much money as the Flats product does. Is there any other way to describe the Postal Service record of **losing over \$5 billion over 10 years on one product**, with multi-hundred million dollar losses every single year, as a “truly persistent negative-cost-coverage situation”? In any other business, the product would have been properly priced or discontinued. Indeed, one wonders if any product has ever been offered by any company anywhere in the world that has ever had a similar track record of offering any product suffering “**truly persistent**” losses of this magnitude.

To drive this point home, the chart which appeared in Valpak’s Reply Comments in Docket No. ACR2017 showing the losses from Flats is reproduced here:

**Table I**  
**Marketing Mail Flats Subsidies**

<b>Fiscal Year</b>	<b>Subsidy (millions)</b>
2008	\$217.8
2009	\$615.6
2010	\$577.0
2011	\$643.2
2012	\$527.9
2013	\$375.9
2014	\$411.0
2015	\$521.7
2016	\$602.0
2017	\$669.3
<b>Total:</b>	<b>\$5,161.4</b>

Source: FY 2017 ACR at 35.

Even under the Commission’s projection based on FY 2016 data, it would add at least another five years of losses, and with FY 2017 losses even greater, would this not meet the Postal Service’s test of a “truly persistent negative-cost-coverage situation”? The answer is yes. And this new position of the Postal Service is at odds with its current position, as only 16 months ago, the Postal Service stated that it “agreed with the Commission that **persistent problems** with provision of timely and **efficient** service to ... Standard Flats continue: problems that pre-date enactment of the Postal Accountability and Enhancement Act of 2006....” Docket No. ACR2015, USPS Response to CIR No. 1 (Nov. 28, 2016) (emphasis added).

As to the second reason for delay, how could it not be said that all “other efforts to improve cost coverage have failed”? The initial finding of noncompliance with PAEA was found by the Commission in Docket No. ACR2010 (Mar. 29, 2011) — seven years ago. In ACDs before that, and in every one since then, the Commission has exhorted the Postal Service to reduce the costs of Flats, and in every succeeding docket, the Postal Service has reported that it has been unsuccessful in doing so. *See* Order No. 4257 at 235. Consider the following illustrative excerpt from a Postal Service report on cost savings measures for flats:

- These [cost coverage] declines have occurred **despite** the Postal Service **taking the steps outlined** in the *Periodicals Mail Study*.

\* \* \*

While the Postal Service believes that some of the savings from those steps began to accrue in FY 2012, it is clear that they did not impact the cost coverage appreciably. Of course, some of the initiatives are longer-term than one year, and in some instances costs from the changes associated with those initiatives have been incurred while the associated savings may take longer to realize.

More generally, while the Postal Service will pursue whatever efficiency enhancements are possible, it is **extremely doubtful** that, in the context of price increases limited to the CPI

cap, the Periodicals class can achieve **100 percent cost coverage**.  
[FY 2012 ACR at 26-27 (emphasis added).]

The Postal Service challenges the Commission to act consistently with its “longstanding Commission practice” as set out in Order No. 1427 (Order on Remand, PRC Docket No. ACR2010-R (Aug. 9, 2012) at 9). USPS Initial Comments at 143. That Order, issued when the losses from Standard Flats were still relatively young, suggested a “totality of circumstances” analysis, including “[h]as the situation persisted for some time? If so, what remedial steps has the Postal Service taken?” It is submitted that under what the Postal Service believes to be Commission practice, yes, losses have “persisted” for some time, and all “remedial steps” have been unavailing.

Yet, in the face of all this evidence, the Postal Service continues to urge a “wait-and-see” approach before the “specter of specific Commission intervention” occurs. USPS Initial Comments at 145. After a decade of financial hemorrhage, there is nothing more to wait for — it is the time for the Commission to act. For all the reasons stated above, and indeed, as a concession to the mortality of man, the Commission must take bold action now to stop the losses from Flats before they are allowed to do even more damage to the institution and its other customers.

#### **B. American Catalog Mailers Association, Inc.**

ACMA filed not only its own comments, but also participated in comments filed by Alliance of Nonprofit Mailers, *et al.*, and joined in comments filed with Parcel Shippers Association, demonstrating that mailers whose rates are being heavily subsidized are highly

motivated to have those subsidies continue. None of those comments offer any reason for the Commission to be dissuaded from its plan to require that these losses soon stop.

The ANM, *et al.*, comments accuse the Commission of error by “ignoring the pro-mailer objectives of Section 3622(b). . . .” Even if that were a reasonable description of the objectives, under the current order, the Commission cannot ignore that to subsidize mailers of Flats, the Postal Service is overcharging mailers using other products, particularly those within Marketing Mail. *See* Kwoka-Wilson Declaration at 17.

These comments describe the underwater problem as a “cost-control problem, not a revenue problem.” ANM, *et al.*, Initial Comments at 85. ACMA even blames “personnel compensation issues.” *Id.* at 86. However, the fact that the Postal Service cannot efficiently sort, transport, and deliver Flats is not a reason not to charge rates that cover costs. *Id.* at 85. Someone must pay those costs, but ACMA’s refrain is reminiscent of what Senator Russell Long (D-LA) reported to be the message he often had heard from lobbyists over the years:

Don’t tax you,  
Don’t tax me,  
Tax that fellow behind the tree.<sup>8</sup>

In Initial Comments that they describe as a “highly critical of the Commission’s approach in this docket” (*id.* at 108), these mailers are even rougher on the Postal Service, as they seek “continued protection from abuse of the Postal Service’s monopoly power.” *Id.* at 109. ACMA and its colleagues blame the Postal Service for everything — productivity losses (*id.* at 87), transportation cost increases (*id.* at 89), the Flats Sequencing System (*id.* at 90),

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<sup>8</sup> <https://quoteinvestigator.com/2014/04/04/tax-tree/>.

“unforced errors in investment and pricing” (*id.* at 91), Postal Service “mismanagement” (*id.* at 101), and the “Postal Service’s deliberate mispricing of Carrier Route Basic flats” (*id.* at 94) leading to sending the wrong pricing signals.

Of course, all of this is quite beside the point which they seek to make. The merits of Postal Service operations do not support the recommendation that the Commission do nothing to address the revenue side of these losses. After a decade of focused cost-cutting measures, the costs are what the costs are. Someone must pay them. ACMA would prefer it not be them. To allow this abusive pricing to continue would be to violate the Title 39 requirement that “postal rates shall be established to apportion the cost of all postal operations to all users of the mail on a fair and equitable basis.” 39 U.S.C. § 101(d). It would be to deny the Title 39 requirement of “reasonable and equitable rates.” 39 U.S.C. § 404(b). Costs that the Postal Service incurs to handle Flats must be borne by mailers who choose to use Flats — not subsidized by other mailers. The Postal Service has no money to continue these subsidies, and its desire to continue them reflects a willingness to over-charge other mailers to generate the funds being lost. ACMA endorses the current system, which somehow may seem reasonable to them. Other mailers, like Valpak, do not choose to pay higher prices for HD/Saturation Letters in order to allow the Postal Service to subsidize other advertising mail entered as Flats — a position that is objectively reasonable.

Lastly, ACMA blames the Commission for its “baffling” “brushoff of flats mailers’ concerns” (ACMA Initial Comments at 103), disregarding the fact that the Commission has done everything it can do for eight years to avoid requiring the Postal Service to raise Flats’ rates, until now it can do nothing else. None of these arguments are persuasive and certainly



does not support these mailers' assertion that the extra surcharges proposed for Periodicals and Marketing Mail Flats "are unlawful." *Id.* at 84.

The Initial Comments filed by ACMA with Parcel Shippers Association also oppose the Commission's proposed additional pricing authority for underwater products, but not because it is illegal, as ANM, *et al.*, argue, but because it is not mandated by law. ACMA/PSA Initial Comments at 4-5.

These Initial Comments again rely on Flats being "part of a suite of flats offerings" and argue that "assessments of cost coverage are most meaningful at the level of combined categories, not MM Flats by itself." *Id.* at 7. This argument has been expressly rejected by the Commission. *See, e.g.*, FY 2012 ACD at 116.

These Initial Comments argue: "Don't waste your cap on a product whose volume is disappearing." ACMA/PSA Initial Comments at 10-11. This familiar argument is not persuasive, because it disregards analysis of all of the effects of rational pricing. First, Flats volume has been decreasing despite half-billion dollar annual subsidies, but it is still substantial. Imposing a price increase on Flats will likely cause reduced volume, which would reduce Postal Service losses. Second, volume of other profitable products generally has been steady, but if they were charged lower prices, the volume would likely grow, and grow significantly. This is particularly true for former ECR Subclass mail, which has very high reported elasticity. *See* Postal Service Econometric Estimates of Demand Elasticity for All Postal Products, FY 2017 (Jan. 19, 2018). Growing the volume of a highly profitable product such as HD/Saturation Letters should be a high priority of the Postal Service, as it would be for any business, but the Postal Service loads burdens on that and other Marketing Mail

products to generate funds used to give underwater pricing benefits to favored Flats mailers. The Postal Service has tested this theory for years, as the cap has been applied to stable and growing volume products, and the result has been a \$5 billion loss since enactment of PAEA. It is time to chart another path.

Lastly, the Initial Comments filed by ACMA alone do not directly focus on the surcharge for underwater Flats, but urge the Commission to reject what it calls “extreme intervention,” even though it concedes “the current path is not sustainable....” ACMA Initial Comments at 3-4.

### **C. The Public Representative.**

The Initial Comments of the Public Representative summarize the recommendations of its expert, Dr. Kwoka, that: “the solution to non-compensatory rates for the flats product could be addressed by raising rates for flats providing offsetting reductions were made in the prices of other Standard Mail products.” PR Initial Comments at 57. This is exactly what the Commission proposes to do. However, the PR stated that it “supports the Commission’s goal of increasing revenue from non-compensatory products and classes [but] not the mechanisms proposed....” *Id.* at 58. Why would that be?

The PR appears to have only one reason to oppose compensatory pricing: the PR believes that requiring the Postal Service to increase prices for underwater products would “tak[e] away the Postal Service’s pricing prerogative.” *Id.* at 59. Although the PR apparently believes that these prices should be raised, it does not want the Commission to compel the Postal Service to make any pricing changes. Since such a laissez-faire approach would encourage the Postal Service to continue to lose a half-billion dollars per year on Flats, the PR

suggests that only then, if “the Postal Service chooses not to increase non-compensatory prices, an objection to that failure would, under current law, have to be raised by complaint.”

*Id.* What the PR does not explain is that, if the complaint procedure is used under current law, the Commission has the full authority to:

order that the Postal Service take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements, and to remedy the effects of any noncompliance (such as ordering **unlawful rates to be adjusted to lawful levels**, ordering the cancellation of market tests, ordering the Postal Service to **discontinue providing loss-making products**, or requiring the Postal Service to make up for revenue shortfall in competitive products). [39 U.S.C. § 3662(c) (emphasis added).]

The PR never explains why the objective of “pricing flexibility” (Objective 4) should be elevated over all other objectives. Neither does the PR explain that pricing flexibility is not an abstract goal, but rather PAEA specifies the purpose behind granting the Postal Service a measure of “pricing flexibility” as set out in 39 U.S.C. § 3622(c)(7):

the importance of pricing flexibility to encourage [i] increased mail volume and [ii] operational efficiency. [Factor 7.]

It would seem logical, that the type of “increased mail volume” that was envisioned by this provision was revenue which paid its way and contributed to the institutional costs of the Postal Service (Objective 8; Factor 2). It would make no sense to believe that pricing flexibility was designed to encourage increased mail volume which loses money for the Postal Service, hurting both it and other mailers. And, it also makes no sense to believe that pricing flexibility should be used to encourage increased “operational efficiency” by pricing decisions which signal mailers as follows: (i) encouraging the entry of Flats, which the Postal Service

has demonstrated it cannot handle efficiently, while (ii) discouraging the entry of letters, which the Postal Service can handle extremely efficiently.

Thus, “pricing flexibility” is not a superior objective — as it is listed as number 4 among a list of 9 objectives. And “pricing flexibility” employed by the Postal Service to benefit favored mailers is not a legitimate reason to exercise it. Moreover, when used to defeat the goal to “encourage increased [profitable] mail volume and operational efficiency,” it not only can, but must be limited by the Commission.

Importantly, the PR cites its own expert witnesses who “urge that rates for [non-compensatory products within compensatory classes] be allowed to reset to compensatory levels as soon as possible.” PR Initial Comments at 59. Indeed, the Declaration of John Kwoka and Robert Wilson filed by the PR as part of its Initial Comments, amplifies this point:

[P]rices for these **non-compensatory products have already damaged the Postal Service’s operations** and hampered any effort at putting it on a firmer financial ground. **That effect will persist** so long as these rates are non-compensatory. We therefore recommend that these rates should be reset to their respective per-unit variable cost **as soon as possible** in order to **prevent further harm** to the Postal Service, and also to **eliminate the economic inefficiency** associated with **below-cost pricing**. [Kwoka-Wilson Declaration at 17 (emphasis added).]

Valpak agrees. The Flats product has already damaged Postal Service finances and operations, and that harm will continue until remedied by the Commission. Prices should cover costs as soon as possible to prevent further harm to the Postal Service.

Lastly, the PR submitted with its Initial Comments the Supplemental Declaration of Timothy J. Brennan which provided important analysis of the problem presented by underwater Periodicals, but which are certainly applicable to Marketing Mail Flats:

When a class or service **fails to cover attributable cost**, it is failing to make any contribution toward the institutional cost; rather, it is **taking funds away from the institution**. **If volume for that service falls**, that service will drain less from the institution, making **USPS more solvent**. The **Commission is correct** in Order No. 4258 to treat these services differently and allow them to **increase price so that revenues at least cover attributable cost**. [Brennan Supplemental Declaration at 9 (emphasis added).]

Fully consistent with the Kwoka-Wilson Declaration, and applied to the Flats product, the principles articulated by Professor Brennan are unquestionably correct:

- underwater Flats “takes funds away” from the Postal Service<sup>9</sup>;
- reduced volume of underwater Flats makes “USPS more solvent”; and
- the Commission was correct to take steps to ensure that revenues from Flats at least cover attributable costs.

Valpak urges the Commission to follow through on its plan to order significant and rapid increases in the price of deeply underwater Marketing Mail Flats, consistent with its statement in its Annual Compliance Determination, that “the Commission has proposed a holistic solution for all underwater products in” this docket. FY 2017 ACD (Mar. 29, 2018) at 56, n.86. This action is necessary to prevent future harm to the Postal Service and to mailers of other products.

Respectfully submitted,

/s/

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<sup>9</sup> The Commission has adopted this position. *See* Order No. 4257 at 234-35 (“non-compensatory products threatened the financial integrity of the Postal Service because the revenue from these products failed to cover their attributable cost.”).

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